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STATE PASS USTR FOR MELLE AND CHANDLER
USDOC FOR UNDERSECRETARY ALDONA AND ITA/IA/JTERPSTRA
USDA FOR FAS - PAULINE SIMMONS

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TAGS: ETRD EAGR SENV CA
SUBJECT: SOFTWOOD LUMBER: A MODEST PROPOSAL

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11. (SBU) Summary: We appear to be moving toward yet another trade-restrictive, time-limited softwood lumber agreement. If so, it might be useful to think now about what we could do to come up with a more durable solution while the temporary measures are in place. The fact that current trade law forces us to focus almost exclusively on Canadian subsidies makes it difficult for either the USG or the GOC to address adequately the broad range of interests affected by the issue (e.g., U.S. producers more concerned by the quantity of Canadian lumber entering the U.S. market than by its price). Post proposes that a non-binding assessment by the International Joint Commission (IJC) of forest practices, state of the lumber industry and related issues could provide a broader range of options for resolving the dispute than would be possible from a purely trade law perspective. This cable also outlines a notional scope of work for an IJC study. End Summary.

Trade Law Inadequate To Meet Producer Concerns

12. (SBU) Twenty years of trade litigation, export taxes and/or import volume restrictions have yet to resolve the U.S.-Canada softwood lumber dispute. Post believes this is because existing trade law is too narrowly focused to deal with the broad range of concerns and long-term industry trends underlying the dispute. Trade law forces us to look almost exclusively at identifying and countervailing Canadian forest management practices that directly or indirectly subsidize Canadian lumber manufacturers. U.S. producers often argue publicly that all they want is a level playing field, with Canadian timber (and hence, lumber) prices "set by the market." Post firmly believes, and the recent WTO panel decision on the countervail case appears to confirm, that subsidies exist and threaten material injury to U.S. producers. But even if we assume that establishing fairness in price competition can be achieved through trade litigation, would that be enough to satisfy U.S. producer interests? Four years of intensive discussion, debate and economic analysis convince us that even if Canadian provinces were to eliminate all subsidies and adopt the U.S. public lands model (an unlikely prospect), competitive pressure from Canadian imports would be virtually unabated for most U.S. softwood lumber firms. We have seen no credible economic studies to the contrary. In fact, the shake-out of poor performers such as BC-based Doman due to current U.S. tariffs may actually be strengthening long-term Canadian competitiveness.

13. (SBU) Some U.S. producers have proposed quantitative import restrictions, combined with punitive tariffs for import volumes exceeding those restrictions. Their interest seems to be in limiting Canada's share of the U.S. market in order to raise prices and increase profit margins for U.S. producers. This might work were it not for the fact that substitute suppliers (New Zealand being the latest to join the ranks) and alternative products (structural steel) are readily available to fill the gap, keeping lumber prices below the level at which some U.S. producers can successfully compete. In short, trade litigation might bring the Canadians to the negotiating table, and trade negotiations might result in import quotas for Canadian lumber, but neither will ensure a healthy U.S. lumber industry over the long haul.

14. (SBU) Other U.S. producers (and some Canadians) say the root of the problem is that there is too much lumber flooding the market, regardless of source. They claim that reducing annual North American production by ten billion board feet would raise prices enough to ensure the long-term health of the lumber industry. They note that such a reduction will inevitably happen as the North American industry continues to consolidate and integrate. If this view is correct, the role of government would seem to be limited to appropriate antitrust surveillance and social safety net support for displaced sawmill workers, since positive measures to reduce production --

e.g., through changes in forestry or environmental policies -- risk a strong negative reaction from consumers. In any case, if this "industry in transition" argument is correct, Post does not see how current trade law or policy tools could be used to make the transition smoother or less painful.

A Role for the International Joint Commission?

15. (SBU) The International Joint Commission has an enviable record of success in resolving bilateral disputes, going back ninety years. While its remit has been largely limited to environmental matters, its success in resolving sensitive boundary water resource management disputes make it a reasonable venue for assessment of a dispute over long-term management of North America's forest resources. In order for such a study to be done under IJC auspices, both the USG and GOC would have to finance it and agree on its scope of work. When one considers the amount of taxpayer money both governments have spent over the past 20 years on litigation, discussion and negotiation, a study that broadens the scope of interests covered beyond those usually addressed under trade law, within limits set by both governments, without prejudice to any existing policy, litigation or negotiation seems like a bargain. Further, we believe an IJC study with an appropriate scope of work could provide a more creative and comprehensive roadmap to resolving the dispute than has been possible heretofore.

16. (SBU) The IJC could, as directed by both governments, contract with independent experts for studies on any or all of the following elements:

-- The current state of the lumber industry (binational, national, regional); industry trends (binational, national and regional); the degree of cross-border integration and prospects for further integration or industry consolidation; socio-economic impact of integration/consolidation (binational, national, regional); global industry trends and their impact on the industry (binational, national, regional); industry trends in substitute products (global, binational, national, regional).

-- Current forest management practices and principles (state/province and federal); recommendations for regional or species-based best practices; economic impact of current practices and recommended best practices by region, nation and binationally; environmental impact of current practices and recommended best practices by region, nation and binationally; species-specific recommendations and economic/environmental assessments; economic and environmental assessments of alternative or complementary economic activities on forest lands, public and private.

-- Prospects for development of employment alternatives in regions identified as most likely to be negatively affected by any of the above-mentioned trends or recommendations.

17. (SBU) We recognize that this would be an ambitious undertaking, even for the IJC. However, faced with the prospect of another 20 years of doing what we have always done and getting the same results over and over again, we believe it would be worth doing. It would certainly show greater concern for the interests of the average taxpayer than what we have managed to do to date. Post would welcome comments from interested Washington agencies on the feasibility and utility of a non-binding IJC study.

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